

**6. In 2010, about 81 percent of the BT costs were attributable to purchases of software licenses and support, and contract services, and would not benefit significantly from further outsourcing efforts by IAWC.**

- Contract services of [REDACTED] were principally related to the system integrator who was selected via a competitive bid process. (See Exhibit IV-4)
- The software licenses and support of [REDACTED] were principally related to the ITS platform, which was selected by a competitive bidding process. (See Exhibit IV-4)

**7. The allocation of AWWSC BT program costs to IAWC in 2010 was 8.9 percent.**

- In 2010, IAWC was charged \$2.4 million or 8.9 percent of the BT costs incurred by AWWSC. (See Exhibit IV-2)
- The 8.9 percent approximates the 8.7 percent formula based on number of customers.

**8. The \$5.5 million charged to IAWC for ITS cost are within industry norms. Combined BT and ITS costs of \$7.9 million exceed industry norms and the additional BT charges were not reflected in terms of reduced AWWSC fees and improved service quality in 2010.**

- As indicated in Exhibit IV-3, the total ITS costs charged to IAWC in 2010 was \$5.5 million.
- AWWSC also charged IAWC \$2.4 million for BT in 2010.
- In 2010, IAWC's ITS costs of \$5.5 million, or 2.4 percent, of revenues were comparable to the average utilities spend of 2.5 percent of revenues.<sup>30</sup>

**9. The \$2.4 million for BT in addition to ITS costs must be evaluated on its own merit.**

- The additional \$2.4 million BT costs are being incurred to improve AWK's IT capabilities and therefore should be included when considering the total AWWSC ITS charges to IAWC and are in excess of the 2.5 percent of revenues (industry norm).

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<sup>30</sup> DR 221

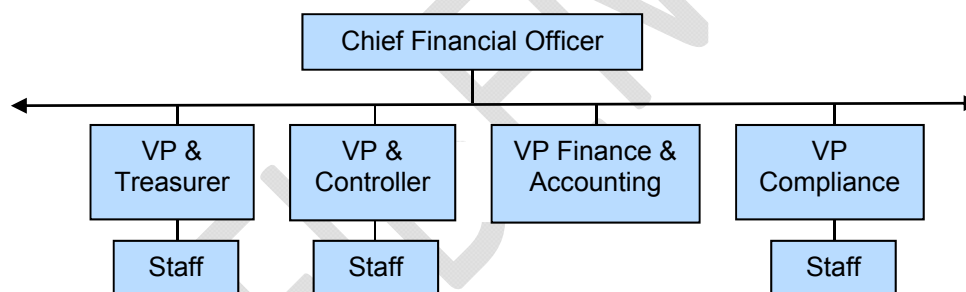
## V. CORPORATE FINANCE

This chapter addresses the corporate finance functions provided to IAWC by AWWSC, including outsourcing options available for these functions. In 2010, IAWC was charged \$1.2 million by AWWSC for corporate finance services.

### A. BACKGROUND

The AWWSC corporate finance functions are responsible for the overall supervision and control of AWK's financial books and records, and for reporting on its financial performance to outside stakeholders, including financial regulators, shareholders and the Internal Revenue Service (IRS). The groups providing these functions are located in New Jersey and report to the Chief Financial Officer (CFO), as shown in as shown in **Exhibit V-1**.<sup>1</sup> These functional groups provide support to both regulated and non-regulated businesses.

**Exhibit V-1**  
**2010 Corporate Finance Organization<sup>2</sup>**



The CFO is one of four direct employees of AWK.<sup>3</sup> The costs associated with these employees are not allocated to the operating companies, but borne entirely by the corporate shareholders.

The compliance group has responsibility for implementing, testing and monitoring AWK's compliance with the Sarbanes-Oxley (SOX) Act of 2002. From 2003 until April 2008, AWK was an indirect wholly-owned subsidiary of a German firm and was not required to comply with SEC or SOX requirements. AWK was required to comply with Section 404 of SOX for the first time for all of 2009. The refinement of SOX compliance systems was still in process through 2010 and the compliance group reported directly to the CFO. It was staffed with the VP and eleven analysts and compliance managers, as well as additional resources provided through outside contractors. In 2011, the group was reorganized to report to the controller.

<sup>1</sup> Other departments reporting to the CFO are addressed in other sections of this study.

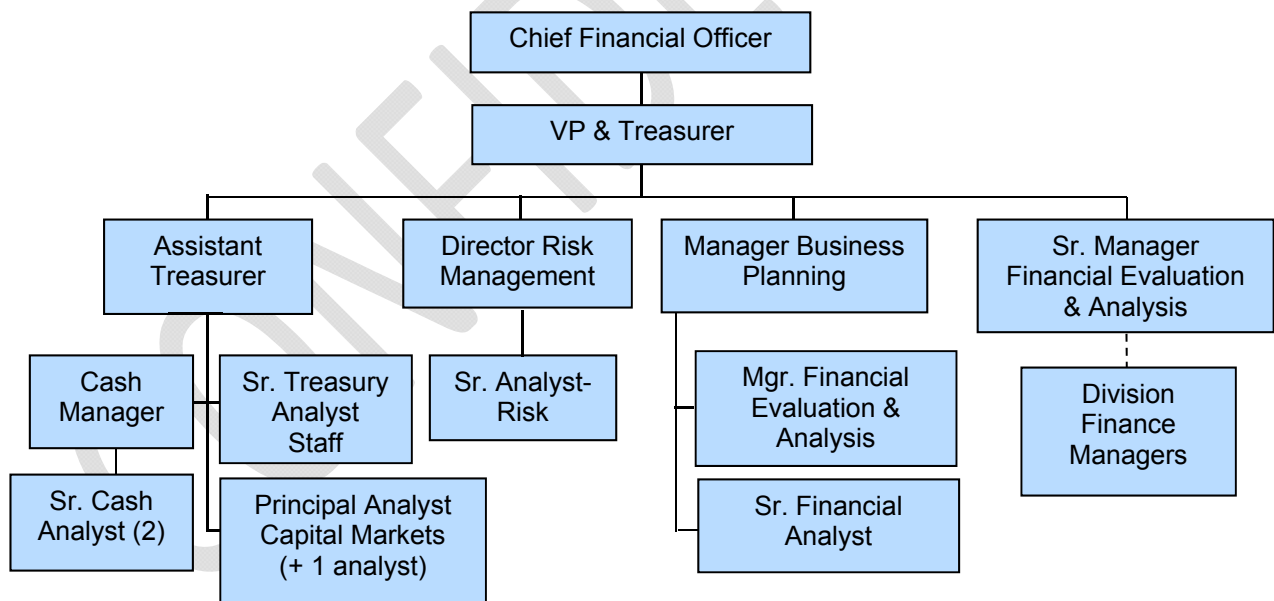
<sup>2</sup> DR 2 and 241

<sup>3</sup> The other AWK employees are the AWK Chief Executive Officer (CEO) and the executive assistants for the CEO and the CFO.

The organization of the treasury department is shown in **Exhibit V-2**. This department includes the following subgroups and services:

- Assistant treasury administers AWK's investment in the operating companies, oversees borrowing and debt compliance activities, and handles the internal cash pooling and any external short-term borrowing or lending by AWK. Many of these activities are executed through American Water Works Capital Corporation (AWWC) a wholly-owned subsidiary established to handle the financing needs of AWK and its subsidiaries.<sup>4</sup> Recently, IAWC reissued some long-term debt, and worked with the Assistant Treasurer to identify and evaluate options and to execute the issuance.<sup>5</sup>
- Risk management oversees the Enterprise Risk Management Register and coordinates insurance other than group health, including workers compensation, property and casualty, and directors' and officers' policies.
- Corporate financial planning and analysis oversees much of the planning (budgeting) and financial analysis activities at the corporate level.
- Financial evaluation and analysis provides financial modeling and related services for BD activities, principally for the regulated operations.

**Exhibit V-2**  
**2010 AWWSC Treasury Organization<sup>6</sup>**



The Treasurer also serves as president of AWWSC, overseeing its budgeting and service level agreements with the operating subsidiaries.

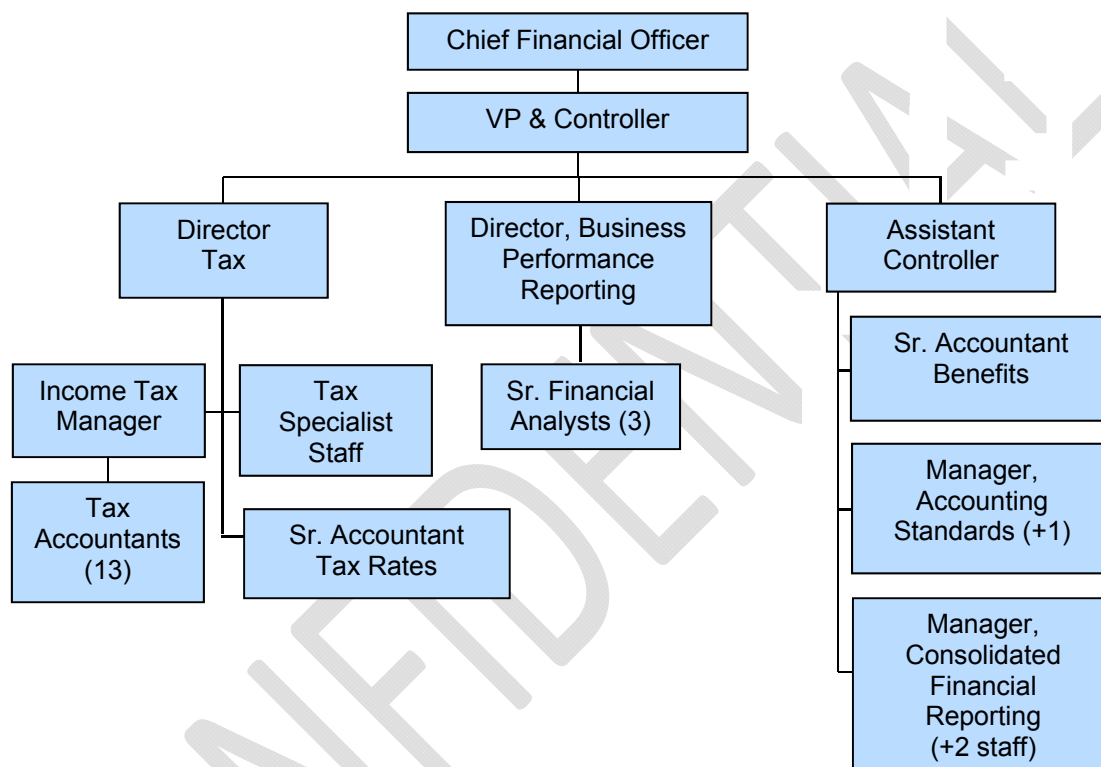
<sup>4</sup> DR 1, Testimony of J. Young, Docket 09-0319, p. 4.

<sup>5</sup> IS 3 and DR 124 confidential

<sup>6</sup> DR 2 and 241

The organization of the controller's office is shown in **Exhibit V-3**. The controller is responsible for external financial reporting and compliance, particularly with the Securities Exchange Commission (SEC), the IRS, and the Financial Accounting Standards Board (FASB). The controller is also involved in the financial analysis activities, particularly as they related to preparation of external financial reports (10-Ks and 10-Qs and the Annual Report to Shareholders).

**Exhibit V-3**  
**2010 AWWSC Controller's Office Organization**



The income tax group within the controller's office is responsible for internal calculations related to income taxes. An outside firm performs the actual preparation of income tax returns for AWK and its subsidiaries. In 2010, the tax group consisted of the Tax Director and seventeen staff; in 2011 the group was reorganized and reduced in size to the Tax Director and eight staff.

In addition to the compliance, treasury, and controller functions, corporate finance includes the VP finance and accounting, who is responsible for financial, accounting and reporting aspects of the employee benefits programs.<sup>7</sup>

In 2010, IAWC was charged \$1.25 million for corporate finance services, as summarized in **Exhibit V-4**.<sup>8</sup> This represents 8.5 percent of the \$14.8 million total AWWSC costs in

<sup>7</sup> IS 56

<sup>8</sup> NorthStar Analysis based on DR 55 confidential

these functional areas. The charges shown in the exhibit include approximately \$300,000 in outside contractor fees charged to IAWC. Approximately half of those fees were for income tax preparation and half for contractor support for the compliance group. In total, AWWSC charged IAWC for 10,291 hours – approximately five FTEs – of corporate finance services in 2010, at an average cost of \$93.10 per hour.

**Exhibit V-4**  
**2010 Corporate Finance Function Charges to IAWC**

<b>Business Unit</b>	<b>IAWC</b>	<b>AWWSC</b>	<b>Percent</b>	<b>Labor Hours</b>
032007 CORP-Finance	\$254,659	\$2,934,929	8.7%	2,462
032017 CORP-Planning & Reporting	76,634	927,430	8.3%	719
032027 CORP-Reporting & Compliance	371,737	4,387,288	8.5%	2,661
032047 CORP-Income Tax	334,076	3,681,461	9.1%	2,433
032057 CORP-Treasury	216,926	2,843,272	7.6%	2,015
037777 CORP - IFRS Finance	64	750	8.5%	0
<b>TOTAL</b>	<b>\$1,254,096</b>	<b>\$14,775,131</b>	<b>8.5%</b>	<b>10,291</b>

**B. TASKS PERFORMED**

To complete the work in this area, NorthStar performed the following tasks:

1. Determined the cost of services and associated labor hours charged by AWWSC during 2010 for corporate financial functions, and identified charges and cost allocations that did not appear to conform to AWWSC allocation procedures.
2. Reviewed relevant portions of the IAWC's testimony, exhibits and supporting documentation from Docket 09-0319 specific to corporate finance functions.
3. Reviewed responses to data requests related to the provision of corporate finance services.
4. Conducted interviews with executives and senior management involved in corporate finance activities.
5. Developed scope of services, representing the services provided to IAWC by AWWSC<sup>9</sup> that could reasonably be provided by competitive providers:
6. Researched feasibility of outsourcing corporate finance functions and contacted possible competitive service providers to obtain pricing for the corporate financial services currently obtained from AWWSC.
7. Based on the information provided by IAWC and the responses to outsourcing inquiries assessed the reasonableness of prices and value of the services provided by AWWSC.

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<sup>9</sup> DR 314

8. Prepared a task report.

## C. RESULTS

### 1. Charges from the AWWSC corporate finance groups are allocated appropriately based on the entities supported.

- **Exhibit V-5** shows the time charged to IAWC by AWWSC corporate finance business units by the allocation factors used to charge distribute the time.<sup>10</sup>

**Exhibit V-5**  
**2010 Corporate Finance Hours Charged to IAWC by Allocation Factor Used**

Business Unit	Allocation Factor Used		
	Tier 2 (All Regulated)	Tier 1 (Corporate)	All Others
032007 CORP-Finance	7	2,273	182
032017 CORP-Planning & Reporting	4	708	8
032027 CORP-Reporting & Compliance	0	1,425	1,237
032047 CORP-Income Tax	2,433	0	0
032057 CORP-Treasury	395	1,341	280
037777 CORP IFRS Finance	0	0	0
<b>TOTAL Hours Charged</b>	<b>2,839</b>	<b>5,747</b>	<b>1,707</b>

- Members of the income tax group allocate their time to regulated entities only (Tier 2 allocation factor), consistent with their principal support for regulated entities rather than the non-regulated entities.<sup>11</sup>
- Members of the finance and the planning & reporting business units allocate the majority of their time using the Tier 1 allocation factors that spread charges to both regulated and non-regulated entities, consistent with their AWK responsibilities.<sup>12</sup>
- Members of the treasury and compliance groups allocate their time across corporate (Tier 1), all regulated entities (Tier 2) and other allocation factors (principally to a division level), consistent with the breadth of their responsibilities.<sup>13</sup>
- Only six individuals (out of the 60 staff in these business units) directly assign their time to IAWC or to the Central (now Western) Division. The bulk of these hours are from the Sr. Manager for financial evaluation and analysis, who provides support to the states on BD projects and from two individuals in the compliance group who provide division-specific SOX compliance support.

<sup>10</sup> NorthStar analysis based on DR 55 confidential

<sup>11</sup> IS 54 and 65

<sup>12</sup> IS 53, 54, and 56

<sup>13</sup> Ibid.

**2. Some corporate finance functions are not relevant for an individual subsidiary, cannot be outsourced, and were not included in the outsourcing solicitation.**

- In evaluating the feasibility of outsourcing corporate finance functions, the existing corporate relationship between IAWC and AWK was left in place. In particular, IAWC continued as a wholly-owned subsidiary of AWK without publically traded stock.
- Corporations whose stock is publically traded require SEC filings and SOX compliance. As a wholly-owned subsidiary of AWK, IAWC has no need to comply with the SEC filing requirements, and SOX compliance is maintained at the AWK level.
- Since IAWC employees would remain AWK employees with continued participation in the AWK employee benefits programs, IAWC cannot separately perform the analyses and filings on the benefits programs that are currently provided by the VP - finance and accounting.
- Accordingly, these services were not included in the scope of services provided to potential outsourced financial service providers.

**3. No vendors were interested in or able to provide the comprehensive oversight, coordination, and control functions provided to IAWC by AWWSC's corporate finance groups.**

- Ten vendors were contacted to provide pricing on the following scope of services:
  - Cash liquidity management, including monitoring Line of Credit, investing excess cash, monitoring of lockbox contractors and performance.
  - Long-term financing: bond placement, retirement/refinancing decisions.
  - Preparation of operating budgets and revenue projections.
  - Coordination of capital project budgeting with company management.
  - Coordination of SOX compliance testing and documentation (actual testing separate).
  - Coordination with accounting back office to ensure accuracy, timeliness and compliance with standards.
  - Identification and communication of changes in accounting requirements and standards, and effect on accounting operations.
  - Coordination with regulatory personnel relating to regulatory filings, compliance with regulatory orders.
  - Preparation of monthly income tax accruals, monitoring of tax law changes and oversight of income tax preparation (by outside contractor).
- None of the vendors were willing to provide prices for the range of services identified.

- Potential vendors raised several concerns, including authorization to act on behalf of the company as a contracted service provider, and conflict of outsourcing with inherent corporate responsibility and governance issues.

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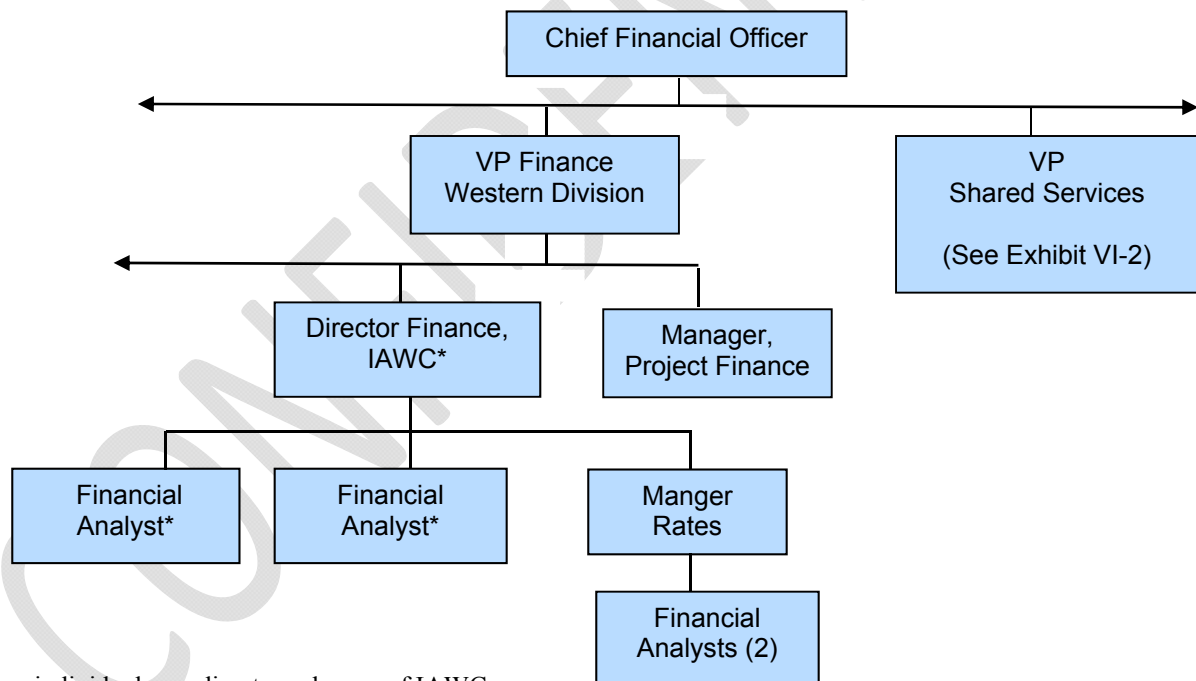
## VI. ACCOUNTING SERVICES

This chapter addresses the accounting services provided to IAWC by AWWSC, including outsourcing options available for this function. In 2010, IAWC was charged \$2.1 million for accounting services.

### A. BACKGROUND

AWWSC provides accounting services to IAWC and its other subsidiaries through the SSC located in Cherry Hill, New Jersey, the Central (now Western) Division staff located in St. Louis, Missouri, and the IAWC accounting staff in Illinois, as shown in **Exhibit VI-1**. For purposes of this analysis, accounting functions are those relating to processing revenue and expense transactions and performing internal reporting and analysis.

**Exhibit VI-1**  
**2010 Organization of AWWSC and IAWC Accounting Functions<sup>1</sup>**



\* These individuals are direct employees of IAWC

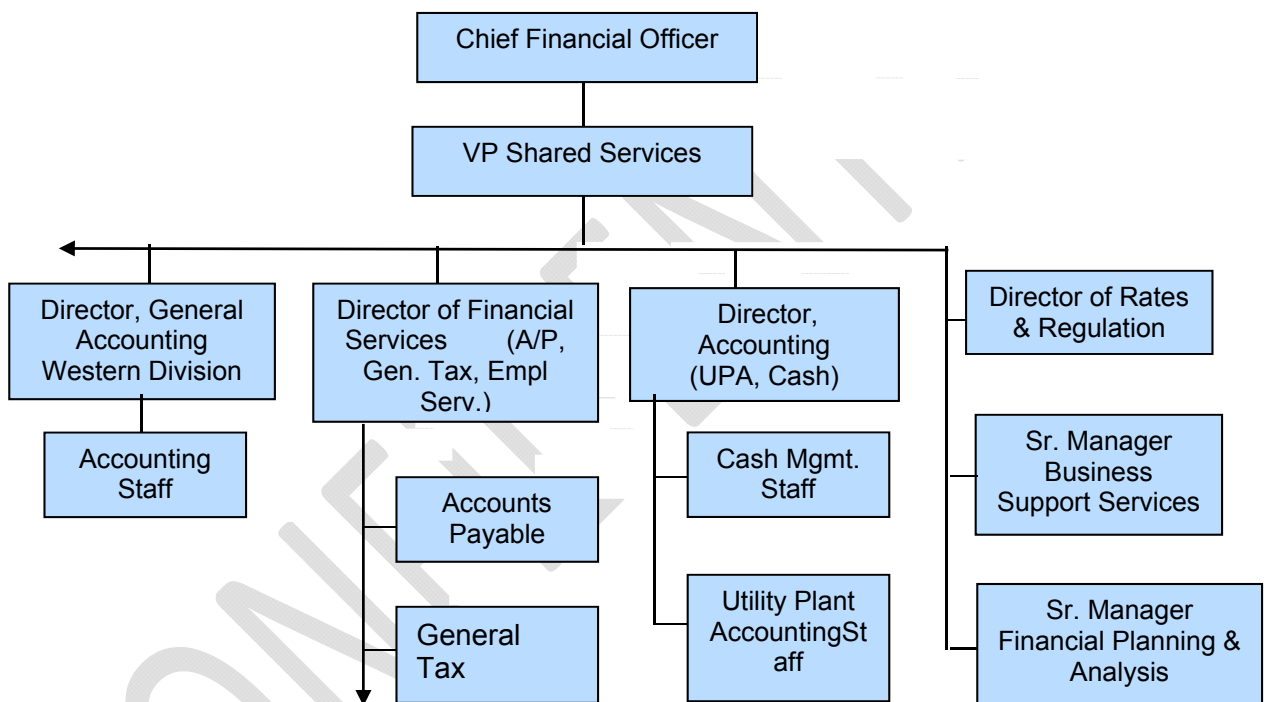
The division-level finance group, based out of St. Louis, Missouri, provides mostly management and supervisory "span of control" services to IAWC and the other states in that division, including assisting with variance analyses, and other general oversight and support functions. Within IAWC, there are three finance personnel who only support Illinois and are not AWWSC employees. The rates manager and his two direct reports, who are AWWSC

<sup>1</sup> DR 2 and 241

employees, provide rate case and implementation support to other states in the Western Division, although they report to the IAWC finance director.

The SSC provides back office accounting services for all AWK affiliate entities, both regulated and non-regulated. The functions provided include: general accounting, financial reporting, payroll processing, oversight of accounts payable and purchasing card transactions, invoice payments, processing of capital and fixed asset transactions, receipt and distribution of cash, general tax services, and support for regulatory rate proceedings.<sup>2</sup> The organization of SSC is shown in **Exhibit VI-2**, and the services provided by each group are summarized below.

**Exhibit VI-2**  
**2010 Shared Service Center Organization<sup>3</sup>**



- The General Accounting (GA) function performs standard accounting activities related to the proper recording of revenues, expenditures, accruals and other entries into an entity's financial books and records. Within GA, specific individuals are assigned to support individual states, including IAWC.
- The financial services function is responsible for accounts payable, general taxes, and payroll services (addressed in Chapter X – Human Resources). Accounts payable has responsibility for processing the majority of vendor interactions (processing invoices for payment, payment inquiries, and Form 1099 preparation). The general tax function is

<sup>2</sup> DR 1, Testimony of J. Young, Docket 09-0319, p. 25.

<sup>3</sup> DR 2 and 241



responsible for preparation and filing of property, franchise and all other non-income taxes for all states.

- The cash management group reconciles lock box deposits, researches unmatched deposits, reconciles bank ledgers, and handles processing of check payments for the accounts payable department.
- Utility plant accounting staff work with capital project managers in the states to set up work orders, clear transactions, prepare reconciliations and calculate construction work in progress (CWIP) amounts. Within this group, individuals are assigned to specific states and charge their time to those states.<sup>4</sup>
- The rates and regulation group provides rate case support to all states, including preparing rate case schedules and responding to data requests requiring extraction of financial data. While this group provides support to the regulatory function, performing these tasks requires detailed understanding of the financial books and records and the accounting software, so it is included in this functional area.
- Business support services provide training to SSC staff, manage specific projects within SSC, and generate state-specific reports, handle configurations for approvals and otherwise provide user support relative to the JD Edwards Accounting software. Additionally, business support services houses the SSC "business liaisons" who serve as account managers to the operating companies.
- The financial planning and analysis group provides budgeting and cost analyses of the performance of AWWSC. This group also maintains the allocation factors used to allocate costs among operating companies.

**Exhibit VI-3** summarizes the charges from the AWWSC accounting functions to IAWC. The \$2 million charged to IAWC represents 8.9 percent of the \$22.9 million total AWWSC costs in these functional areas. In total, AWWSC provided 32,461 hours – 15.6 FTEs – of accounting services to IAWC in 2010, at an average cost of \$63.33 per hour.

**Exhibit VI-3**  
**2010 Accounting Service Charges to IAWC<sup>5</sup>**

Business Unit	IAWC	AWWSC	Percent	Labor Hours
032570 SSC-General Accounting	\$240,255	\$3,079,273	7.80%	4,240
032084 SSC-Accounts Payable	138,499	1,936,131	7.20%	4,265
032571 SSC-Tax	102,773	1,188,657	8.60%	2,354
032575 SSC-Cash Operations	152,119	1,772,727	8.60%	3,511
032577 SSC-Utility Plant Accounting	198,044	1,947,202	10.20%	3,970

<sup>4</sup> IS 97

<sup>5</sup> DR 55 confidential

032572 SSC-Business Support Services	125,253	1,409,858	8.90%	1,963
032574 SSC-Rates & Regulation	132,590	1,816,295	7.30%	1,684
032578 SSC-Project Management	26,063	316,130	8.20%	287
032580 SSC-AWE	19,422	1,279,115	1.50%	1
032505 SSC-Administration	210,948	2,399,611	8.80%	1,649
<b>TOTAL</b>	<b>\$1,345,966</b>	<b>\$17,144,999</b>	<b>7.85%</b>	<b>23,924</b>
033507 CE - Finance	\$685,762	\$2,745,949	25.00%	7,933
034007 SE - Finance	14,288	2,705,586	0.50%	440
036507 NE - Finance	593	303,038	0.20%	19
<b>Total Division Support</b>	<b>\$700,643</b>	<b>\$5,754,573</b>	<b>10.45%</b>	<b>8,392</b>
<b>Total Accounting Services</b>	<b>\$2,046,610</b>	<b>\$22,899,572</b>	<b>8.94%</b>	<b>32,316</b>

As part of the business case for the BT project, presented in December 2008, the following factors were identified as examples of challenges in the AWK accounting processes:<sup>6</sup>

- Finance costs as a percentage of revenue are more than double the average of median class companies
- Finance FTEs at more than double the average of median level companies
- Account reconciliations are 100 percent manual
- Financial data analysis requires specialized knowledge
- Data extraction cumbersome.
- Extensive manual intervention required to reconcile between the customer information system and the accounting systems

The BT business case concluded, “[o]verall, AW systems are obsolete, cumbersome, and not integrated resulting in manual processes and inefficiencies.” The business case included an estimate of \$50 million in benefits to AWK. The estimated benefits included a potential 30 percent reduction in all finance and accounting (“Record to Report”) headcount.

## B. TASKS PERFORMED

To complete the work in this area, NorthStar performed the following tasks:

1. Determined the cost of services and associated labor hours charged by AWWSC during 2010 for the accounting function, and identified charges and cost allocations that did not appear to conform to AWWSC allocation procedures.
2. Reviewed relevant portions of the IAWC’s testimony, exhibits and supporting documentation from Docket 09-0319 specific to the accounting function.

<sup>6</sup> DR 110, p. 5 confidential



3. Reviewed responses to data requests related to the provision of accounting services.
4. Conducted interviews with executives and senior managers relating to accounting services.
5. Based on the groups included in the accounting function and the services they provide, developed a "scope of services," representing the services provided to IAWC by AWWSC<sup>7</sup> that could reasonably be provided by competitive providers.
6. Researched feasibility of outsourcing the accounting functions.
7. Contacted possible competitive service providers to obtain pricing for the accounting services currently obtained from AWWSC.
8. Based on the information provided by IAWC and the responses to outsourcing inquiries, assessed the reasonableness of prices for the services provided by AWWSC.
9. Prepared a task report.

## C. RESULTS

- 1. IAWC was charged \$34,293 in 2010 by AWWSC accounting business units that did not provide it with any services.**
  - IAWC was charged \$19,422 associated with one hour of labor from the SSC-AWE business unit, the group within SSC that provides accounting services for the AWK non-regulated entities. The cost of the labor was \$25, with the remainder of the charges related to the distribution of overheads from SSC.<sup>8</sup> AWWSC provided no explanation of the services provided to IAWC by the non-regulated business employee.
  - IAWC was charged \$14,871 by divisional finance units that support other divisions. The amount charged by SE-finance represents mostly time coding errors.<sup>9</sup> The \$583 charged by NE-finance is assumed to be the result of a coding error.
- 2. IAWC could reduce its cost for accounting functions by up to \$1 million annually by outsourcing these services.**
  - Eight possible providers of outsourced accounting services with utility industry expertise were contacted and asked to provide pricing for the following scope of accounting services, with the metrics shown in **Exhibit VI-4**.
    - Invoice receipt, scanning, initial coding, distribution for approval
    - Processing after approval
    - Check printing and mailing

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<sup>7</sup> DR 158

<sup>8</sup> DR 305

<sup>9</sup> DR 308



- Preparation and distribution of vendor Form 1099
- Management of Procurement card, including circulation of charge records for coding and approval, and preparation of journal entries for posting
- Set up work orders for capital projects, including transaction clearing, reconciliations and calculation of CWIP
- Handling of accounting for customer advances
- Entry of new assets, capital improvements and retirements
- Preparation of depreciation schedules and journal entries for posting
- Inventory posting and oversight of annual physical inventory warehouses
- Daily reconciliation of cash balances, lock box deposits
- Research of cash deposit exceptions
- Preparation of invoices for miscellaneous income (e.g., third party damage collections)
- Processing of refunds and miscellaneous income checks
- Preparation of general tax filings – property taxes, ad valorem taxes, use taxes
- Support for audit filings
- All postings for the general ledger (G/L), journal entries, adjustments in accordance with GAP and standard utility system accounting
- Preparation of trial balances and preliminary monthly financial statements
- Preparation of reports on budget vs. actual, and initial explanation of variances
- Coordination with operations personnel for approval of charges, research of variances, coding questions
- Coordination with regulatory personnel for compliance with regulatory orders and preparation of schedules for regulatory filings
- Coordination with AWK finance for cash needs, capital funding, information needed for SEC filings (10Q, 10K) and SOX compliance.

**Exhibit VI-4**  
**Metrics for Outsourcing Accounting Services<sup>10</sup>**

<b>Function</b>	<b>Metric (Annual unless otherwise noted)</b>
Accounts Payable	18,000-25,000 invoices processed/year
Procurement Card Posting	400 cards, 3-5 transactions/month
Plant Accounting	9,000 overhead calculations 16,000 transactions to close construction to plant in service Maintain 242 depreciation rates & groups
Inventory Postings	\$156M of products/services
Warehouses	52
Lockbox processing	3.5 M bills annually, 12,000 to 15,000 per day 0.1% are exceptions requiring research
General Tax filings	700 property tax filings annually 300 other general tax filings annually
Data Requests	50-150 requests per rate case

<sup>10</sup> DR 134, 135,136, 142, 385

- Two vendors provided cost estimates:
  - Vendor A quoted a range of costs from \$80,000 to \$200,000 per month (\$960,000 to \$2.4 million annually), inclusive of all overheads (taxes, benefits, office expenses, management fees).
  - Vendor B estimated savings of 10 to 20 percent from the current baseline cost. For IAWC this would convert to a cost for accounting services of \$1.6 to \$1.8 million annually.<sup>11</sup>
  - A third vendor was interested but declined to provide pricing information without more specific scope discussions.
- In 2010, IAWC was charged \$2 million by AWWSC for accounting services. While the top end of Vendor A's quote (\$2.4 million) exceeds current AWWSC charges, the range of prices quoted illustrate the potential for saving of \$200,000 to more than \$1 million from the current charges, as illustrated in **Exhibit VI-5**.

**Exhibit VI-5**  
**Comparison of Costs for Accounting Services<sup>12</sup>**

	Vendor A	Vendor B
Current charges from AWWSC (from <b>Exhibit VI-3</b> )	\$2,046,599	
Remove Incorrect Charges (see Finding 1)	(\$34,293)	
<b>Net Accounting Function charges to IAWC</b>	<b>\$2,012,306</b>	
Range of Vendor Prices	\$960,000 to \$2.4 million	\$1.6 to \$1.8 million
<b>Difference from current IAWC charges</b>	<b>-\$1,052,306 to +\$387,694</b>	<b>-\$412,306 to -\$212,306</b>

**3. Implementation of the accounting portion of the BT project is projected to achieve similar savings.**

- The business case for the BT project estimated a potential 30 percent savings on head count in the overall finance and accounting processes. A 30 percent reduction from current accounting costs would reduce the IAWC charges for this function by \$603,691 annually.
- While a large portion of the current accounting costs are tied to head count, either directly (labor and benefits) or indirectly (computers, paper, office space), some costs would not decline with headcount reduction, and other factors, such as cost overruns, could reduce the potential savings.
- Additionally, the estimated savings would have to be imbedded in accounting service budgets and allocations for IAWC to pass these savings to ratepayers.

<sup>11</sup> Based on current charges of \$2 million.

<sup>12</sup> NorthStar research





## VII. INVESTOR RELATIONS

This chapter addresses the IR functions performed by AWWSC, including the costs charged by AWWSC to IAWC and the outsourcing options available for this function. In 2010, IAWC was charged \$60,680 by AWWSC for IR services

### A. BACKGROUND

The IR function has strategic responsibility to provide effective communications with the external debt and equity financing community for AWK. The function combines expertise in finance, communication, marketing and securities law compliance.<sup>1</sup> IAWC is not independently rated by financial rating agencies, and does not issue any debt on its own. Standard & Poor's rates AWK BBB+.<sup>2</sup>

The IR group is comprised of a VP, a manager and an assistant. The group reports directly to the CFO and is located in Voorhees, New Jersey.<sup>3</sup> This group handles mailing proxy statements to individual named investors, coordinates and participates in regular calls with investors to discuss earnings reports, and attends retail investor meetings across the country and internationally to promote investment in AWK. IR uses three outside vendors to support of its work:<sup>4</sup>

- Thomson-Reuters provides access to First Call Research analyst reports, consensus estimates, real time quotes and intelligence on AWK stock movement, bond activity, peer stock access, comparison, and financial ratios analysis. It manages and constantly updates the IR website, a SEC-sanctioned source for corporate governance information, SEC filings, dividend notices and financial news. It enables the company to track web traffic, mine data, get peer conference call transcripts and generate reports to measure investor activity. The Thomson-Reuters contact management platform tracks the history of the hundreds of meetings, phone calls, financial conferences and roadshows conducted by the company, and provides a vehicle to inform stakeholders electronically by e-mail details of company events, conference calls and presentations where investors can have access to AWK management, and learn about AWK financial performance.
- The MWW Group, Inc. - Financial Relations Board (FRB) offers consultation on best practices used by industry leaders, provides advice on securities compliance, media and industry analysis and targeting of new investors. FRB provides resources and support for the company's quarterly performance calls to the public, management of *ad hoc* and special project planning for Investor Day, and perception studies that enable AWK to

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<sup>1</sup> DR 1, testimony of J. Young, Docket 09-0319, p. 26.

<sup>2</sup> <http://www.standardandpoors.com/prot/ratings/entity-ratings/en/us/?entityID=268959&sectorCode=UTIL>, Accessed 10/13/11.

<sup>3</sup> DR 2 and 241

<sup>4</sup> DR 302 confidential





reach out to new investors. FRB creates presentations for financial conferences, non-deal roadshows to retail and institutions that clearly define and disseminate the company history, strategy and mission.

- Broadridge Financial Solutions, Inc. provides services that enable identification of, and access to, retail and institutional investors through which the company can meet its regulatory and listing exchange obligations to hold its annual meetings and associated proxy voting. Broadridge also conducts virtual meetings, which allow more investors to attend, enabling the company a broader reach to investors.

The IR group supports both regulated and non-regulated entities. In recognition of this, the personnel manually allocate their time 50/50 between AWK and all regulated entities. Based on the percent of total IR charges allocated to IAWC, as shown in **Exhibit VII-1**, other charges, including outside contractor expenses, are not allocated in the same manner.

**Exhibit VII-1**  
**2010 IR Charges to IAWC<sup>5</sup>**

	IAWC	AWWSC	Percent
Contract Services - Other <sup>6</sup>	\$16,088	\$220,867	7.28%
All Other Charges	\$44,592	\$774,037	5.76%
TOTAL CHARGES	\$60,680	\$994,904	6.10%

**B. TASKS PERFORMED**

To complete the work in this area, NorthStar performed the following tasks:

1. Determined the cost of services and associated labor hours charged by AWWSC during 2010 for IR functions, and identified charges and cost allocations that did not appear to conform to AWWSC allocation procedures.
2. Reviewed relevant portions of IAWC's testimony, exhibits and supporting documentation from Docket 09-0319 specific to IR functions.
3. Reviewed responses to data requests related to the provision of IR services.
4. Conducted interviews with the VP for IR, the CFO, and other AWK financial executives.
5. Researched the feasibility of outsourcing the IR function and identified possible outsource providers.
6. Based on the information provided by IAWC, interviews, review of feasibility research and other data responses determined the reasonableness of prices for the IR services provided by AWWSC.

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<sup>5</sup> NorthStar analysis based on DR 55, confidential

<sup>6</sup> Function 535000.

7. Prepared a task report for this area.

## C. RESULTS

### 1. AWWSC's inconsistent application of allocation methods for charges from the IR group resulted in IAWC being overcharged \$17,899 for IR services in 2010.

- The members of the IR group manually allocate their time 50/50 between AWK and regulated operations. This allocation reflects a reasonable split of benefits from the IR services. Use of this allocation results in IAWC receiving approximately 4.3 percent of charges (one-half of the standard 8.7 percent Tier 2 customer charge allocation). Data provided by IAWC confirms this allocation for time, with IAWC being charged 89 hours, or 4.3 percent of a standard 2080-hour year.<sup>7</sup>
- Other charges, including the charges for outside contractor assistance, are not being allocated in the same manner. As a result, all regulated entities, including IAWC, are being overcharged by AWWSC for IR services. As shown in **Exhibit VI-1**, IAWC received 7.3 percent of the Contract Services - Other charges, and 6.1 percent of the total IR costs in 2010.
- If all costs incurred by IR were charged in accordance with the 50/50 scheme for labor, then IAWC would have been charged \$42,781 rather than the \$60,680 actually charged.<sup>8</sup>

### 2. Since IAWC does not issue its own stock or debt, it is not feasible to outsource IR services separate from AWK.

- The need for IR is tied to the issuance of stock in a company and the need to provide investors with timely and compliance information on the performance of the company.
- Since IAWC does not issue stock in its own name, all interfaces with the financial markets must be made through its parent company. Thus, outsourcing IR separate from AWWSC is not feasible.

### 3. IAWC receives significant economies of scale from the centralization of the IR function.

- If IAWC were a standalone company, it would likely be considered a "small cap" firm (assets of approximately \$1 billion). Many small cap firms outsource IR services to be able to gain a breadth of expertise that would not be possible to support internally.
- Online research identified several options for outsourcing vendors, with pricing for a subset of needed services ranging from \$4,500 to \$12,500 per month, plus stock options, or \$54,000 to \$150,000 annually.<sup>9</sup> This is significantly more than the \$44,000 to \$60,000

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<sup>7</sup> DR 55 confidential

<sup>8</sup> Calculated as 4.3% of the \$994,904 in total IR expenses in 2010 from DR 55 (Confidential)

<sup>9</sup> NorthStar research. For example, [http://s3.agoracom.com/executive/us\\_ir/index.htm](http://s3.agoracom.com/executive/us_ir/index.htm), accessed 10/13/11.

(depending on the correction of the allocation error noted above) charged by AWWSC for these services.

CONFIDENTIAL

## VIII. INTERNAL AUDIT

This chapter addresses the Internal Audit (IA) services provided to IAWC by AWWSC, and the outsourcing options available for this function. In 2010 IAWC was charged \$221,575 by AWWSC for IA services.

### A. BACKGROUND

The IA function provides an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. IA helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes. The IA process can be a catalyst for improving an organization's effectiveness and efficiency by providing insight and recommendations based on analyses and assessments of data and business processes. With commitment to integrity and accountability, IA provides value to governing bodies and senior management as an objective source of independent advice.<sup>1</sup>

AWWSC IA relies on a variety of sources to develop its annual audit plan:<sup>2</sup>

- Risk Factors and "Additional Factors" as disclosed in the Registration Statement on Form 10-K
- Content from risk management committee meetings
- Risks or issues identified from previously completed audits, management requested projects and investigations
- The IA department's internal list of possible audit topics
- Content from the Business Process Review meetings
- Content from fraud risk detection and assessment activities
- AWW's Code of Ethics
- Input from interviews of selected members of management and the AWW Board of Directors (BoD) audit committee.

The BoD audit committee approves the audit plan. IA resource requirements at the corporate level are forecast during the annual IA planning process, and are set to balance the work required to address regular audit needs and special project focus areas. Resource requirements are updated throughout the year and reported to the audit committee on a quarterly basis.<sup>3</sup>

In 2010, the IA department conducted nine audits of corporate-wide issues and two audits targeted to specific operating companies. The corporate-level audits addressed the following issues:

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<sup>1</sup> Institute of Internal Audit definition of audit

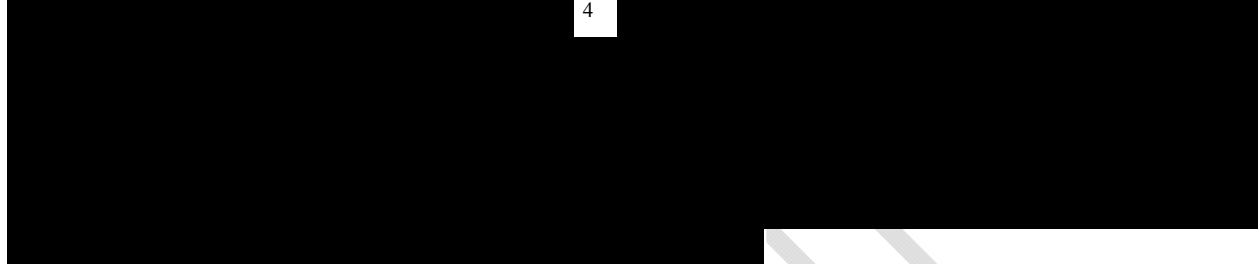
<sup>2</sup> DR 85

<sup>3</sup> DR 91



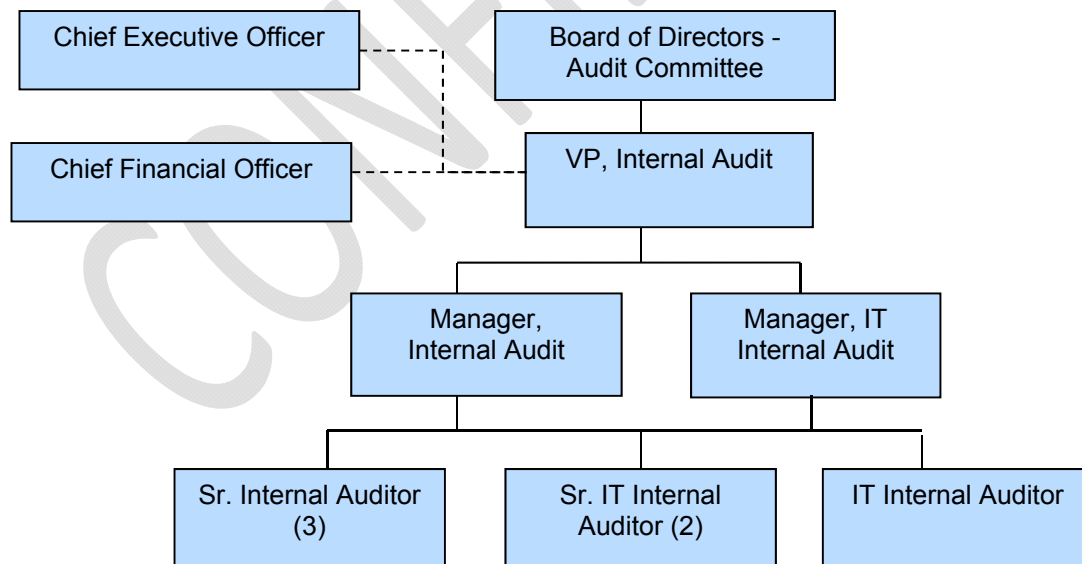
- Treasury department
- Chemical procurement
- Service First
- 2009 annual incentive plan
- PowerPlant
- PowerTax
- AWE contract services
- AWWSC cost distribution
- Business Transformation project

One of the state regulated utility-focused audits concerned IAWC –



The Vice President, IA reports functionally to the Chairman of the audit committee of the AWK BoD, with a “dotted line” to the Chief Executive Officer (CEO), and administratively to the Chief Financial Officer (CFO) for supervision and support only, as shown in **Exhibit VIII-1**. The IA staff includes auditors with specific expertise in ITS systems and compliance. All members of the IA staff are located in New Jersey.

**Exhibit VIII-1**  
**2010 Organization of Internal Audit Functions<sup>6</sup>**



<sup>4</sup> DR 83 - Attachment 1 confidential

<sup>5</sup> IS 61

<sup>6</sup> DR 2 and 241

The total cost for IA services charged to IAWC in 2010 was \$221,575, shown in **Exhibit VIII-2**. These costs include \$44,755 in outside contractor costs. The average rate was \$104.66 per hour.

**Exhibit VIII-2**  
**2010 IA Charges to IAWC<sup>7</sup>**

	IAWC	AWWSC	Percent	Hours
Contracted Services <sup>8</sup>	\$ 44,755	\$ 172,562	25.9%	-
All Other Expenses	\$176,820	\$1,639,148	10.8%	2,117
Total Charges	\$221,575	\$1,811,710	12.2%	2,117

## **B. TASKS PERFORMED**

To complete the work in this area, NorthStar performed the following tasks:

1. Determined the cost of services and associated labor hours charged by AWWSC during 2010 for IA functions, and identified charges and cost allocations that did not appear to conform to AWWSC allocation procedures.
2. Reviewed relevant portions of IAWC's testimony, exhibits and supporting documentation from Docket 09-0319 specific to IA functions.
3. Reviewed responses to data requests related to the provision of IA services.
4. Conducted interviews of management and executives relative to IA services.
5. Based on information from the interviews, data responses, and standard IA activities, developed a scope of services to guide discussions with prospective competitive suppliers.
6. Researched feasibility of outsourcing the IA functions and contacted possible competitive service providers to obtaining pricing for the IA services currently obtained from AWWSC.
7. Based on the information provided by IAWC and the responses to outsourcing inquiries, determined the reasonableness of prices and value of the services provided by AWWSC.
8. Prepared a task report.

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<sup>7</sup> DR 55 confidential

<sup>8</sup> Total of 535000 Contracted Services-Other and 535001 Contracted Services-Temp Employees



## C. RESULTS

### 1. IA appropriately uses direct charging and cost allocation factors.

- Most of the audits performed by the IA group in 2010 related to issues which impacted either all-corporate entities (e.g., regulated and non-regulated) or all regulated entities. This is consistent with the time charges to Tier 1 and Tier 2 allocation factors shown in **Exhibit VIII-3**.
- IAWC was direct charged for the [REDACTED] Audit. IA reported that audit required 764 internal labor hours, and 100 hours by the outside contract auditor, consistent with the 725 hours directly charged to IAWC by IA.

**Exhibit VIII-3**  
**2010 IA Hours Billed to IAWC by Allocation Factor Used<sup>9</sup>**

Allocation Factor	Hours
Tier 2 regulated pool	302
Tier 1 regulated & non-regulated pool	937
Direct charged to IAWC	725
Overhead allocation	153
<b>Total Hours</b>	<b>2,117</b>

### 2. Many firms, including utilities, outsource their IA departments.

- The benefits of outsourcing IA services include:
  - A larger pool of potential auditors with a wider variety of skill sets, and
  - The ability to shift a predominantly fixed cost for internal audit services to a more variable costs.
- Outsourcing IA services leads to higher IA costs in years when more work is required, compared to year when less work is needed.

### 3. IAWC receives the benefit of economies of scale in the services provided by the AWWSC IA function.

- IAWC was billed the equivalent of one FTE in 2010, fewer hours than would be expected for an independent entity of similar size.
- A standard rule of thumb is for one internal auditor for every 250 employees, so a firm the size of IAWC would expect to have two internal auditors on staff.<sup>10</sup>

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<sup>9</sup> DR 55 confidential

<sup>10</sup> Institute of Internal Audit



- Potential outside providers of IA services estimated the average number of hours needed for IA services for a company the size of IAWC would range from 3,200 to 4,500 hours (1.5 to 2.2 FTEs).<sup>11</sup>
4. **The hourly costs charged to IAWC by AWWSC for IA services in 2010 were comparable with the rates offered by competitive outsource providers.**
- Hourly rates and estimated levels of services were obtained from four vendors, using the following scope of services:
    - Two to three operational audits per year
    - Work within the parameters of the current risk matrix system to develop schedule of upcoming audits
    - Work with the audit committee and the CFO to develop and implement internal audits
    - Report to the audit committee.
  - The range of hourly rates provided by the four vendors was between \$90 and \$395 per hour, compared to the average hourly rate for AWWSC IA services of \$104.66, as shown in **Exhibit VIII-4**.

**Exhibit VIII-4**  
**Rates of Competitive IA Providers<sup>12</sup>**

Vendor	Hourly Rates
Vendor A	\$175-\$180
Vendor B	\$150
Vendor C	\$175
Vendor D	\$150
Vendor E	\$90
AWWSC IA In-House rate	\$104.66

5. **The total charges paid to AWWSC by IAWC for IA services are equivalent to or less than the costs IAWC would incur to outsource its portion of the IA functions,**
- IAWC would not be able to completely avoid AWWSC IA charges, because, as a member of AWK some of the topics investigated by the AWWSC IA group would still relate to services received by IAWC. Therefore IAWC would continue to incur some IA charges from AWWSC even if it were to outsource dedicated IA services.
  - It could cost IAWC up to an additional \$527,225 to outsource the IA function, as shown in **Exhibit VIII-5**. Only one vendor quoted hourly rates less than the IA in-house rate, and so could provide the existing level of service at a lower cost than AWWSC.

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<sup>11</sup> NorthStar research

<sup>12</sup> NorthStar research



**Exhibit VIII-5**  
**Comparison of IA Costs from Competitive Providers<sup>13</sup>**

<b>Level of IA Services</b>	<b>Annual Cost</b>
Competitive Provider Costs for one FTE (current level of service) <sup>14</sup>	\$190,530 to \$381,060
Competitive Provider Costs for two FTEs (benchmark level of service) <sup>15</sup>	\$374,400 to \$748,800
IADC Charges for IA Services	\$221,575
<b>Difference</b>	<b>(\$31,045) to \$527,225</b>

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<sup>13</sup> NorthStar analysis

<sup>14</sup> 2,117 hours at \$90 to \$180 per hour

<sup>15</sup> 4,160 hours at \$90 to \$180 per hour

## IX. CUSTOMER SERVICE

This chapter addresses the customer service functions provided by AWWSC, including the costs charged from AWWSC to IAWC, and the outsourcing options available for this function. In 2010, AWWSC charged IAWC \$4.3 million for customer services.

### A. BACKGROUND

AWWSC provides contact center, collections, billing, and business services support for the AWK operating companies. These functions are performed from two CSCs located in Alton, Illinois and Pensacola, Florida. AWWSC currently uses five outside vendors in support of its customer service work. These vendors provide translation services, bill print and mailing services, and first- and third-party collections.

#### Contact Center

The contact center handles customer inquiries and correspondence and processes service order requests 24 hours per day, seven days per week. AWWSC's contact centers have 409 seats serving the AWK operating companies: 172 in Alton and 237 in Pensacola. The average number of actual customer service representatives (CSRs) in 2010 is provided in **Exhibit IX-1**.

**Exhibit IX-1**  
**2010 CSC Call Handling CSRs – Average All States<sup>1</sup>**

Location	General Call Handling	Specialty Desk	Total
Alton	103	16	119
Pensacola	136	56 (Pennsylvania)	192
<b>Total</b>	<b>239</b>	<b>72</b>	<b>311</b>

Calls coming in from a Chicago metro area code are routed to a specialty desk, which also handles calls from Monterey, California. The Chicago metro desk was established in response to regulatory requirements stemming from a meter change program in the Chicago metro area. Representatives in either Alton or Pensacola handle other Illinois customer calls. CSRs handle customer inquiries and schedule customer service appointments as needed. Emergency calls are answered in the contact center and immediately routed to the state Field Resource Coordination Center (FRCC) for dispatch. Calls that cannot be resolved by the CSR can be escalated to a higher level of management. Billing inquiries or disputes can be sent to the billing department for further review and follow-up.

In 2010, the CSC processed 549,394 IAWC inbound calls (about 1.8 calls per customer), an average of about 45,000 per month, with an August peak as shown in **Exhibit IX-2**.<sup>2</sup> The

<sup>1</sup> DR 364

<sup>2</sup> DR 186d

549,394 inbound calls include calls handled via self-service in the IVR, calls handled by GC services and calls handled by CSC CSRs. The call volume has increased each year. Although call volume is tracked by state, CSRs are not assigned to a specific state, with the exception of specialty desks noted above.<sup>3</sup>

**Exhibit IX-2**  
**Illinois Monthly Inbound Call Volumes<sup>4</sup>**

	2009	2010	2011
1-Jan	44,715	42,078	47,566
1-Feb	39,357	37,594	42,426
1-Mar	42,742	43,737	48,961
1-Jan	39,115	40,393	43,773
1-May	41,969	42,179	46,223
1-Jun	45,894	49,393	48,651
1-Jul	48,004	51,144	
1-Aug	50,022	58,332	
1-Sep	42,712	48,818	
1-Oct	45,193	47,230	
1-Nov	38,358	45,233	
1-Dec	40,360	43,263	
<b>Total</b>	<b>518,441</b>	<b>549,394</b>	

In 2010, the CSC also had an outbound Illinois call volume of 4,569, an average of 381 calls per month.<sup>5</sup> Outbound calls are typically follow-up to an inbound call.

An outside vendor handles foreign language calls requiring translation. AWWSC determined that it was not cost effective to have the required language capabilities on staff and outsourced the function. Costs for interpretation service for IAWC customer are directly charged to IAWC.<sup>6</sup>

## **Billing**

IAWC sends out about 273,000 customer bills per month – a total of 3.3 million in 2010.<sup>7</sup> AWWSC billing representatives process bill files, perform manual billing - as necessary, address escalated billing inquiries from the contact center, resolve billing exceptions that do not require field investigation, issue field service orders for those billing exceptions it cannot resolve, implement billing controls, and perform applicable SOX testing.<sup>8</sup> IAWC's customer relations function performs a number of meter reading reviews to ensure the completeness and accuracy of the process. IAWC performs meter read edits, and reviews reports to identify consecutive estimates and zero usage. The CSC billing department performs billing edits. These include

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<sup>3</sup> DR 364

<sup>4</sup> DR 186d

<sup>5</sup> DR 186d and 360

<sup>6</sup> DR 187

<sup>7</sup> DR 186d

<sup>8</sup> DR 186 and I. 108

review of accounts with multiple estimated reads and high/low bills. (See Chapter XII - Customer Relations) **Exhibit IX-3** provides details of the Illinois billing workload.

**Exhibit IX-3**  
**AWWSC Annual Billing Workload – IAWC<sup>9</sup>**

Function	Workload
Total bills mailed	3,271,129
Manually billed accounts	83 accounts, 996 manual bills
Billing exceptions reviewed	238,694
Billing adjustment/corrections	24,302
Rate structure updates to the customer information system	11
Billing inquiries	9,715
Escalated inquiries	4,007

Bill print services are outsourced by AWWSC and are directly invoiced to IAWC.

Billing is currently plagued by a number of manual processes and inefficiencies, which should benefit from the BT project. The BT business case describes the existing inefficiencies.<sup>10</sup> These inefficiencies are for the billing function as a whole and affect all operating companies.

- Approximately 147 methods and practices are required to address district rules for setting up premises. (See Chapter XII - Customer Relations regarding premise work.)
- No capability of an end-to-end reconciliation to confirm all customer base meters were read and billed.
- Manual creations of over 2,200 back bills and/or leak adjustments per month (requires 16 FTEs at 75 percent labor hours).
- Average of 766 manual billing adjustments daily (requires 65 FTEs at 50 percent labor hours).
- 28 reports tracking billing integrity must be run in each of 19 separate state environments in order to compile information at enterprise level (7 FTEs at 75 percent labor hours).

### Collections

AWWSC (and its vendors) provide collections strategy, delinquency and termination notification, inbound and outbound collections calling, payment arrangements, and recovery services for IAWC accounts in arrears. AWWSC outsources the majority of its customer contact collections work to two vendors: GC Services and Penn Credit. These costs are billed directly to IAWC based on work performed for IAWC.

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<sup>9</sup> DR 186 and 365

<sup>10</sup> DR 110 confidential

GC Services provides first-party collections services for the operating companies under a contract with AWWSC. The majority of this work is responding to calls and making payment arrangements for customers who have received a delinquency or termination notice. GC Services was obtained through a competitive bid process in 2007. In 2010, GC Services handled 84,335 inbound and 25,865 outbound calls for IAWC.<sup>11</sup> In addition to personnel costs, the hourly rate charged by GC Services includes the use of its automated dialer, site, technology systems, toll-free numbers, and direct routing to AWWSC's payment vendor for customer interested in processing payments without the involvement of a live collector. Not included in the hourly rate are the costs associated with transfers to AW or ORCC, the outbound dialer, or overtime.

GC Services also makes outbound customer calls in response to designated collections dialing campaigns and attempts to reach customers prior to disconnection. In 2010, AWWSC conducted two outbound dialing campaigns on behalf of IAWC: customers issued a disconnection notice or eligible for disconnection, and customers with a balance of \$50 or more. In 2010, 25,865 outbound calls were made on behalf of IAWC.<sup>12</sup> IAWC's customer relations group also makes an attempt to contact customers prior to termination, as discussed in Chapter XII – Customer Relations.

Penn Credit provides third-party collections services. Thirty days prior to an account being written off, it is transferred to Penn Credit, which attempts to collect on the account. As is fairly typical in the industry, Penn Credit is paid a percentage of the amount it is able to recover. In 2010, \$2.8 million dollars of IAWC charge-offs were placed with Penn Credit. Penn Credit recovered [REDACTED].<sup>13</sup>

AWWSC establishes the collection strategy and timeline in accordance with regulatory requirements, identifies accounts eligible for delinquency and disconnection notices, prepares and submits delinquency and disconnection notices, addresses customer payment disputes and manages the external collections agencies. In general, IAWC sends final and disconnect notices to residential accounts with a past due balance of \$75 and \$100 for other accounts.<sup>14</sup> In 2010, AWWSC sent 207,501 final notices and 72,926 disconnection notices to IAWC customers.<sup>15</sup>

### **Administration and Business Services**

Administration costs include the VP of customer service and an administrative team. The VP of customer service provides a corporate role and works with AWWSC senior management to develop and administer policies affecting the provision of customer services. The VP also provides leadership to CSC by setting the vision, and developing the strategy and plans to achieve targets established in collaboration with the operating companies that CSC services. An office manager and administrative team who also provide day-to-day reception, mailroom and other activities for the CSC Alton operation support the VP.<sup>16</sup>

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<sup>11</sup> DR 186d, f and 360

<sup>12</sup> DR 367

<sup>13</sup> DR 368

<sup>14</sup> DR 214

<sup>15</sup> DR 366

Business services provide support for the CSC and field operations. Services include client interaction, relationship management, change request management and continuous business improvement, water quality training, handling of regulatory requests (e.g., rate cases, data requests and site tours), regulatory and high-level complaint and issue investigation and resolution, and support for the Instant Data Access (IDA) information system used by the CSRs. IDA provides alerts and general information, such as payment locations and water quality issues. IDA also provides a snapshot of customer specific information, which is used by the CSRs.

## Costs

**Exhibit IX-4** summarizes the AWWSC service company costs charged to IAWC and costs for AWWSC-procured vendors direct billed to IAWC in 2010. In 2010, AWWSC allocated \$4.331 million to IAWC. Another \$1.962 million was direct billed to IAWC. AWWSC costs are charged to cost centers which may support one or more of the core customer service function.

**Exhibit IX-4**  
**2010 Customer Service Costs Charged to IAWC<sup>16</sup>**

<b>AWWSC Customer Service Costs Charged to IAWC</b>	<b>2010 Costs</b>
034005 CCA-Administration	\$ 324,764
034070 CCA-Call Handling	834,330
034071 CCA-Billing	688,064
034072 CCA-Collections	220,267
034073 CCA-Operations & Performance	397,548
034074 CCA-Business Services	127,491
034075 CCA-Education & Development	86,197
037005 CCP-Administration	96,836
037070 CCP-Call Handling	1,062,491
037073 CCP-Operations and Support	274,358
037075 CCP-Education & Development	113,632
034018 CCA-Human Resources	105,040
<b>Subtotal AWWSC Charges</b>	<b>\$4,331,019</b>
<b>Customer Service Costs Direct Invoiced to IAWC</b>	
Language Services	
Bill Print and Production	
Mailing	
First Party Collections	
Third Party Collections	
<b>Subtotal</b>	<b>\$1,959,510</b>
<b>Total Customer Service Costs</b>	<b>\$6,290,529</b>

NorthStar segregated the CSC costs into contact center, billing, collections and other support costs. **Exhibit IX-5** provides the breakdown.

<sup>16</sup> DR 55 confidential, 187 and 260

**Exhibit IX-5**  
**AWWSC Customer Service Costs by Function<sup>17</sup>**

	Contact Center	Billing	Collections	Other [1]	Total
<b>AWWSC Costs Charged to IAWC</b>					
034005 CCA-Administration	\$159,118	\$57,720	\$18,478	\$89,448	\$ 324,764
034070 CCA-Call Handling	834,330				834,330
034071 CCA-Billing		688,064			688,064
034072 CCA-Collections			220,267		220,267
034073 CCA-Operations & Performance [2]	397,548				397,548
034074 CCA-Business Services				127,491	127,491
034075 CCA-Education & Development [2]	86,197				86,197
037005 CCP-Administration	96,836				96,836
037070 CCP-Call Handling	1,062,491				1,062,491
037073 CCP-Operations and Support	274,358				274,358
037075 CCP-Education & Development	113,632				113,632
034018 CCA-Human Resources [2]	105,040				105,040
<b>Subtotal AWWSC Charges</b>	<b>\$3,129,551</b>	<b>\$745,784</b>	<b>\$238,744</b>	<b>\$216,939</b>	<b>\$4,331,019</b>
<b>Costs Direct Invoiced to IAWC</b>					
Language Services					
Bill Print and Production					
Mailing					
First Party Collections					
Third Party Collections					
<b>Subtotal</b>					<b>\$1,959,510</b>
<b>Total Customer Service Costs</b>				<b>\$216,939</b>	<b>\$6,290,529</b>

Note 1: Includes cost of correspondence, return mail, certifications and business services.

Note 2: In its verification response, IAWC indicated that a portion of these costs support collections and billing, but did not provide specific numbers.

The BT business cases provided a very preliminary estimate of savings for the AWWSC customer service function (contact center, billing and collections) of \$12.6 million (26 FTE). If these savings are realized, about \$1.2 million of benefit should accrue to IAWC.<sup>18</sup>

## B. TASKS PERFORMED

To complete the work in this area, NorthStar performed the following tasks:

1. Determined the cost of services obtained from AWWSC during 2010 for customer service.
2. Identified other customer service costs direct invoiced to IAWC.

<sup>17</sup> NorthStar Analysis, DR 55 confidential, 187 and 260

<sup>18</sup> Data Response 110. Customer service costs are allocated to IAWC based on the number of customers. IAWC represents about nine percent of the AWK customer base.



3. Estimated the proportion of total customer services costs for contact center, billing and collections services.
4. Reviewed the relevant portions of IAWC's testimony, exhibits and supporting documentation from Docket 09-0319.
5. Reviewed responses to data requests related to the provision of customer service.
6. Conducted interviews with executives and senior management involved in customer service activities.
7. Identified the methodology to be used for pricing, possible service providers and other factors needed to obtain or develop competitive prices.
8. Developed scope of services, representing the services provided to IAWC by AWWSC that could reasonably be provided by competitive providers.
9. Contacted potential competitive service providers to obtain pricing for specific services. Not all service providers contacted would provide pricing estimates due to the size of IAWC or NorthStar's inability to sign a Non-Disclosure Agreement.
10. Compared the competitive cost of services to the AWWSC costs.
11. Developed conclusions regarding the reasonableness of costs charged by AWWSC given the competitive pricing.
12. Prepared a task report.

## C. RESULTS

- 1. NorthStar was unable to obtain viable bids for outsourcing the entire customer service function.**
  - Contact center and collections are functions frequently outsourced by a variety of entities including utility companies.
  - Few providers able to handle the entire customer service function.
  - Similarly, few providers offered the required billing analytical support function provided by AWWSC.
- 2. AWWSC costs for contact center services are higher than outsourced options, by \$428,831 or more per year.**
  - NorthStar obtained preliminary pricing information from eight vendors to provide on-shore, 24/7, contact center services. Vendors used IAWC's monthly call volume, call arrivals pattern, Average Speed of Answer (ASA) (80 percent of all calls within 30 seconds) and Average Handle Time (AHT) (5:30) performance standards, and new CSR



training requirements in developing their pricing. Vendors assumed they would have access to AWWSC's customer information system and IDA.

- Outsourced contact centers typically charge a fully loaded rate for a logged in and available agent hour that includes labor and all associated contact center costs.<sup>19</sup>
- In 2010, IAWC paid an estimated \$3.146 million for contact center services as shown in **Exhibit IX-5**, above. The costs include call personnel, overheads, expenses, facilities, technology, quality assurance, supervision, scheduling, work management, human resources and training costs.
- NorthStar contacted and received quotes from a number of contact center and collections service providers. Some vendors declined to provide a quote as IAWC's call volume fell below their minimum requirements. Quotes ranged from \$25 to \$28 per hour as shown below. Costs for an offshore solution, pooled resources, or more typical hours of operations would be even lower.

**Exhibit IX-6**  
**On-Shore Contact Center/Collections Cost Estimates<sup>20</sup>**

Vendor	Cost	Basis
Vendor A	\$25.25	Per logged hour
Vendor B	\$25.00 to \$28.00	Per logged hour. Range depending on the skills/ caliber of the resource.
Vendor C	\$28.00	Per logged hour
Vendor D	\$20.00 to \$30.00	Per agent hour (includes breaks but not lunch). \$20 for call center resource, \$30 for ITS resource.
Vendor E	\$27.00	Per logged hour. Training time would be charged at a lower rate
Vendor F	Typically low to mid \$20s	Per logged hour
Vendor G	\$24.75 - \$27.00	Per hour, not including set-up, training and telecom, if applicable. A typical set-up normally ranges from \$5,000 to \$7,500.
Vendor H	\$26.00	Per hour, per agent. Does not include telecommunications/connection charges.

- AWWSC provided NorthStar with its effective hourly rate of \$34.95<sup>21</sup> less start-up costs, compared to \$25 to \$28 for the outsource vendors, a difference of \$7 to \$10 per hour. NorthStar believes AWWSC's effective rate may actually be higher.
  - In calculating the \$34.95 rate, AWWSC excluded management, administrative and facilities expenses from its costs, thus providing a conservative lower bound on the estimate of savings.

<sup>19</sup> A logged/available agent-hour refers to the time an agent spends in the seat logged into the system and available to take calls. In addition to the facilities, systems and other technology costs, the rates include scheduling, supervision, monitoring and reporting, and quality assurance.

<sup>20</sup> NorthStar Analysis

<sup>21</sup> DR 412

- NorthStar is unable to validate these costs, but does not believe all administrative and facilities costs should be removed in determining AWWSC's rate, as these are included in the outsourced vendor's cost structure.
- **Exhibit IX-7** provides the AWWSC rate calculation.

**Exhibit IX-7**  
**AWWSC Contact Center Rate Calculation<sup>22</sup>**

AWWSC Cost	AWWSC Calculation	Notes
Initial Estimated Contact Center Cost	\$3,003,894	
Less curriculum development	(40,537)	Determined by AWWSC (DR 412)
Less business services	(127,491)	Not included in NorthStar's initial \$3.146 million cost – see Exhibit IX-5
Less correspondence, return mail and certifications	(89,448)	Not included in NorthStar's initial \$3.146 million cost – see Exhibit IX-5
Less administrative expenses	(285,283)	Determined by AWWSC (DR 412)
Less facilities charges	(435,757)	Determined by AWWSC (DR 412). Facilities costs are included in vendor costs and were not eliminated from NorthStar's cost
<b>Subtotal</b>	<b>\$2,025,378</b>	
Less vendor management [Note 1]	(140,000)	Annual cost estimated provided by AWWSC (DR 412)
<b>Total</b>	<b>\$1,885,378</b>	
Illinois Hours	53,941	
<b>Rate</b>	<b>\$34.95</b>	

Note 1: If IAWC were to outsource the contact center, additional IAWC personnel (one to two FTE at a cost of about \$140,000)<sup>23</sup> would be required to manage the vendor and monitor performance.

- Using the 2010 Illinois agent hours provided by AWWSC and an average \$27 per hour, yields an annual outsourced cost of \$1.456 million, as shown in **Exhibit IX-8**, a minimum savings from an outsourced solution of \$428,831. This assumes AWWSC's rate and hours are accurate.<sup>24</sup>

**Exhibit IX-8**  
**Vendor – AWWSC Cost Comparison<sup>25</sup>**

	Rate	Hours	Cost
Average all vendors	\$27.00	53,941	\$1,456,407
AWWSC	\$34.95	53,941	1,885,238
<b>Difference</b>			<b>\$428,831</b>

- AWWSC estimates an additional \$200,000 in start-up costs for training and cutover would be required if the contact center were to be outsourced.

<sup>22</sup> DR 412 and Exhibit IX-5

<sup>23</sup> DR 412

<sup>24</sup> Hours are allocated to IAWC, and do not represent the actual level of effort.

<sup>25</sup> DR 412 and vendor survey

**3. The collections costs direct billed or allocated to IAWC are reasonable and consistent with competitive information.**

- Currently AWWSC outsources the majority of its collections work and is in the midst of a new Request for Proposal (RFP) process to competitively select its outside collections agencies.<sup>26</sup>
- About half of IAWC's collections costs are billed directly to IAWC by outside vendors. The current vendors were selected through a competitive bid process.
- **Exhibit IX-9** provides details of GC Services costs. These costs are within the range of the costs for contact center and inbound collections services obtained by NorthStar (\$25 to \$28 per hour).

**Exhibit IX-9**  
**2010 GC Services Costs – IAWC<sup>27</sup>**  
**CONFIDENTIAL**

	Hours	Cost per Hour	Notes
Subtotal			
Subtotal			

Note: Table does not include overtime charges or call transfer charges.

- Penn Credit is paid a percentage of the amounts it recovers as is typical for the industry.<sup>28</sup> Penn Credit is currently paid █ percent, which is within the range charged by third party collection agencies.<sup>29</sup>
  - Depending on the type of debt, the age of the account and how many attempts have already been made to collect on it, the fee could range from 10 to 50 percent (though more typically the fee is 25 to 40 percent).<sup>30</sup>
  - NorthStar contacted three collection agencies not on AWWSC bidders list. Fees ranged from 18 to 20 percent, 20 to 25 percent and 20 to 50 percent depending on the age and account balance.

<sup>26</sup> It is NorthStar's experience that utility companies typically outsource third-party collection activities. Frequently first-party collections activities are also outsourced. Collections strategy and vendor oversight are commonly performed in-house, as is the case with AW.

<sup>27</sup> Data Responses 213 and 361

<sup>28</sup> Companies typically either sell the debt after write-off or pay third party collection agencies a percentage based on recovery.

<sup>29</sup> DR 187

<sup>30</sup> Legrady, Paul (2005-09). "Creditors Exercising Options For Receivables Management", Business Credit 107 (8): 62-63

- AWWSC's cost for postage and paper for delinquency notices is \$0.46 per notice. According to AWWSC, GC Services projects the cost for it to send a letter for AWWSC on an active portfolio could exceed [REDACTED]. This cost does not include the initial cost to set up the letter template.<sup>31</sup> AWWSC sent 280,427 notices on behalf of IAWC in 2010.<sup>32</sup>
- In 2010, AWWSC charged IAWC \$220,267 for services such as collections strategy, delinquency notification, and vendor management. NorthStar assigned a portion of the CSC administrative costs to the collections function, resulting in a total AWWSC cost of \$238,744. This is equivalent to 2 to 3 FTE.

**4. Bill print and production are frequently outsourced and are currently outsourced by AWWSC.**

- IAWC is invoiced directly for these charges.
- In 2010, IAWC paid [REDACTED] for bill production, printing and mailing. **Exhibit IX-10** provides details of the 2010 costs based on 3,499,685 bills printed in 2010.

**Exhibit IX-10**  
**2010 Bill Production, Print and Mail Costs – IAWC<sup>33</sup>**

Category	Cost per Bill
Production and Print	[REDACTED]
Mailing/Postage	[REDACTED]

- One vendor contacted by NorthStar provided a range of typical costs for these services of \$0.34 to \$0.36 for postage and \$0.12 to 0.18 for a one sheet printed statement. IAWC's costs are within this range.

**5. No outsourced vendor would bid for the manual billing and the bill review and error edits services currently performed by AWWSC.**

- Meter-to-cash service providers would not provide a cost estimate given the relatively small size of IAWC.
- AWWSC charged IAWC and estimated \$745,784 (\$0.21 per bill) for this function in 2010, including allocated administrative costs. Costs for billing are relatively high due to current system limitations and these should be addressed by the BT project.
- The BT business case included the following billing benchmark comparison.

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<sup>31</sup> DR 211

<sup>32</sup> DR 366

<sup>33</sup> DR 260

**Exhibit IX-11**  
**2008 BT Business Case – Billing (Order to Cash)<sup>34</sup>**

Metric	Top	Median	Water Industry	AWWSC
Bills per FTE (annually)	928,651	409,357	331,035	249,541
Unit cost per Bill	\$0.29	\$0.29	\$0.42	\$0.45 plus (does not include current FTE cost)

- Based on the charges to IAWC, NorthStar calculated a total current unit cost per bill including printing and mailing of \$0.73 (2010)<sup>35</sup> compared to a water industry average of \$0.42 (2008).

<sup>34</sup> DR 110 confidential – 2008 data

<sup>35</sup> [REDACTED] from Exhibit IX-5 divided by 3,271,129 bills mailed (DR 365).

## X. HUMAN RESOURCES AND EMPLOYEE SERVICES

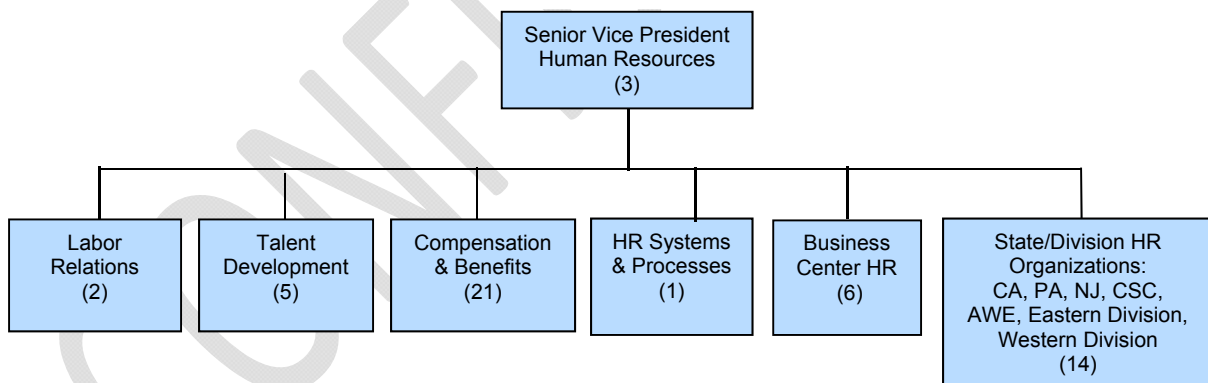
This chapter covers the HR and payroll functions performed by AWWSC, and the associated charges to IAWC. HR services are provided by the HR department and payroll is performed by the employee services group within finance. This chapter does not address the costs of HR services performed for the CSCs in Alton and Pensacola. Those costs are addressed in Chapter IX Customer Service. In 2010, AWWSC allocated \$1.421 million in HR and payroll services costs to IAWC. The term “HR-related services or functions” is used in throughout this chapter to refer to the HR and payroll functions.

### A. BACKGROUND

#### Human Resources

The AWWSC HR Department provides HR services for all of AWK. **Exhibit X-1** shows the AWWSC HR organization as of December 2010. In 2010, IAWC did not have any HR positions. All HR services were provided by the corporate HR business units and the Western Division HR business unit. The number of employees in each business unit is shown in parentheses. In 2010, IAWC had 496 employees. About 70 percent of its workforce (344) was covered by one of 13 bargaining unit agreements.

**Exhibit X-1**  
**AWWSC HR Department<sup>1</sup>**



The AWWSC HR Department is responsible for the development and implementation of human resource strategies to support and advance current and future business objectives, and consists of the following business units:

- Employee & Labor Relations is responsible for corporate employee and labor relations strategy and planning. Primary employee relations activities include oversight of the Code of Ethics reporting process and development/updating of related policies and procedures to cultivate positive and productive working relationships in the union,

<sup>1</sup> DR 241, 411

nonunion, and management workforce.<sup>2</sup> Primary labor relations activities include consultation to senior management regarding AWK's position statement for arbitration, litigation, and grievance meetings/hearings as well as labor relations risk analysis; strategy development across the affiliated companies; research and support for labor negotiations and resolution of issues; and compliance with related federal and state laws, regulatory agency requirements, company policy, and collective bargaining agreements.<sup>3</sup>

- Compensation & Benefits is responsible for AWWSC's total rewards strategy, including planning, compliance, administration, data management, and reporting. Primary activities include job design and evaluation, performance management, compensation and benefits research/market analyses, compensation program management, and leave administration. This department analyzes benefits negotiations and also oversees the health and wellness program. In addition, a unit of this department, the Benefits Service Center (BSC), administers the employee and retiree welfare benefits programs, life insurance programs; 401(k)/pension programs; short- and long-term disability programs, and the employee assistance program. The BSC also manages open enrollment, answers employees' benefits questions, and handles data management and reporting/filings.<sup>4</sup>
- In 2010, HR Systems & Processes was responsible for interfacing with the ITS Department to analyze the options for improving time entry and services for the benefits service center.<sup>5</sup> In 2011, two unit employees were reassigned to the Talent Management Business Unit (renamed HR Corporate Services). When the remaining employee, the project manager, was reassigned to the BT Program in 2011, this unit was eliminated. Plans for reinstatement of this business unit upon completion of the BT Program have not been determined.
- Business Center HR is responsible for HR programs and services for AWWSC's corporate office employees. Primary activities include human resource strategies, policies, and procedures; employee relations; diversity and affirmative action; talent sourcing, development, and retention; compliance with related laws and regulations; and data management and reporting.<sup>6</sup>
- Talent Development handles executive education, leadership development, coaching/mentoring, and succession planning; organizational design, effectiveness, and change; training needs assessment, design, delivery, and evaluation; the selection and management of purchased training packages and vendors; performance management; and designs, facilitates, and provides support for leadership meetings, business conferences, and forums.<sup>7</sup>
- Western Division HR partners with the AWWSC HR business units to provide HR services for employees located in the Western Division office and AWK affiliates in the

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<sup>2</sup> DR 178, 355; IR 94, 100

<sup>3</sup> DR 178, 355, 357; IR 45, 94, 100

<sup>4</sup> DR 178, 351, 352; IR 92

<sup>5</sup> DR 353; IR 45

<sup>6</sup> DR 354; IR 45

<sup>7</sup> DR 178, 252, 295, 356; IR 93, 110



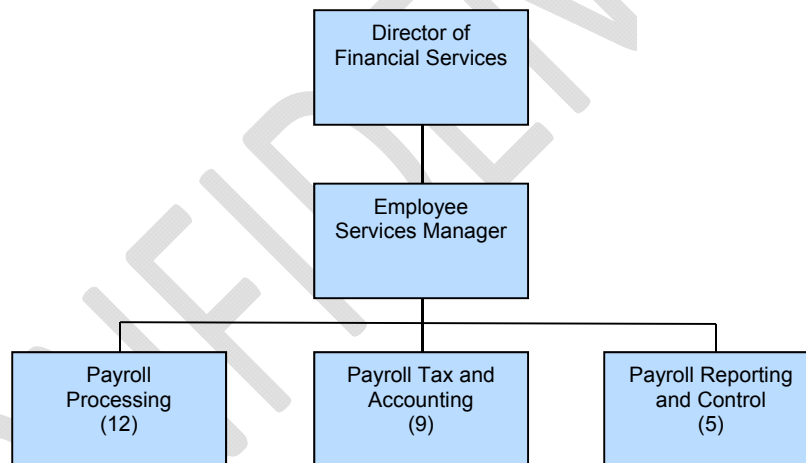
region, which includes IAWC. Primary activities include consultation with corporate HR and local management regarding HR needs and circumstances; oversight, coordination, and day-to-day administration of HR programs, services, and activities for the Western Division office and regional affiliates; local workforce planning and recruitment; employee and labor relations, including negotiations and grievance resolution; compliance; and related recordkeeping and reporting.<sup>8</sup>

In 2010, AWWSC charged IAWC for 17,094 labor hours for HR services. This represents 8.22 FTEs. The ratio of HR FTEs to IAWC employees (496) is about 1:60.<sup>9</sup>

### Employee Services (Payroll)

SSC's employee services group is responsible for providing payroll services for all AWK companies. As shown on **Exhibit X-2**, this department is organized into three work groups: payroll processing, payroll tax and accounting, and payroll reporting and control. The number of employees assigned to each work group is shown in parentheses.

**Exhibit X-2**  
**Employee Services Organization<sup>10</sup>**



IAWC timekeepers are responsible for receiving paper timesheets from IAWC employees and ensuring that they are approved by the supervisor. They enter the time into the JD Edwards accounting system, print and validate edit reports, and obtain manager/supervisor approval. Copies of the approved documents are submitted to employee services via scan or fax for further verification and processing. Payroll is processed biweekly on the same schedule for all IAWC employees.<sup>11</sup>

Employee services performs the following activities: data entry and coding for new hires and changes; payroll processing, data management, and reporting; payroll-related

<sup>8</sup> DR 357

<sup>9</sup> DR 54 confidential

<sup>10</sup> DR 2 (updated for 2010)

<sup>11</sup> DR 40 confidential; IR 95, 114



disbursements and reconciliations; and unemployment administration. Employee services contracts with a vendor to manage payroll tax disbursements across all jurisdictions, print checks, and provide employee access to online payroll information. A second vendor provides unemployment administration, which includes representation at hearings.<sup>12</sup>

In 2010, employee services charged 3,932 hours to IAWC, which is just under two (1.9) FTEs.

### HR and Payroll Costs

In 2010, AWWSC charged \$1.4 million in HR and payroll service costs to IAWC, as shown in **Exhibit X-3**.<sup>13</sup> The charges exclude charges associated with the CSC in Alton, and Eastern Division HR costs mistakenly charged to IAWC.<sup>14</sup>

**Exhibit X-3**  
**2010 AWWSC HR Charges to IAWC**

Business Unit Title	IAWC HR Charges
<b>HR Services</b>	
032018 Corporate HR (SVP HR and other administrative costs)	121,241
032006 Business Center HR	86,044
032013 Corporate HR Systems & Processes	40,916
032004 Corporate Labor Relations	61,207
032038 Western Division Labor Relations	52,102
032003 Talent Development	146,182
032002 Compensation & Benefits (excluding BSC shown below)	146,556
032014 Corporate Benefits Service Center	126,171
032038 Western Region HR Management and Administrative Services	462,205
032048 Corporate HR Health & Wellness	<15>
<b>Subtotal</b>	<b>1,242,609</b>
<b>Payroll Services</b>	
032579 Employee Services	178,896
<b>Subtotal</b>	<b>\$178,896</b>
<b>Total</b>	<b>\$1,421,505</b>

<sup>12</sup> DR 359; IR 95

<sup>13</sup> DR 55 Confidential, 406, 411

<sup>14</sup> DR 289

### **Potential Effect of the BT Program**

AWWSC's HR-related functions depend heavily on manual and paper-based processes due to the lack of an integrated information system. According to AWWSC, HR employees spend nearly 60 percent of their time on transactional and administrative activities. The additional time needed for manual processing and workarounds means less time performing consultative and strategic activities, which would directly support business strategy and create value. AWWSC expects the BT Process to significantly impact HR and employee services, improving productivity and reducing associated costs.<sup>15</sup> AWWSC has projected a 15 percent reduction in overall HR-related FTEs as a result of the BT process.<sup>16</sup>

A 2011 AWK HR benchmarking study showed that AWK's HR cost is about \$2,400 per employee, compared to the median cost of about \$2,100 per employee and the top quartile cost of about \$1,300 per employee, 46 percent less than AWK. AWK's HR FTE ratio is about 1:60 employees, the study median is about 1:90 employees, and the top quartile is about 1:110 employee, 45 percent more employees per HR professional than AWK. While these comparisons are for AWK's business process improvement planning purposes and have not been validated, it is clear that AWK expects to realize significant cost savings and overall productivity improvements upon completion of its HR transformation process, which addresses HR's information system needs as well as process improvements targeting efficiency and effectiveness metrics.<sup>17</sup>

## **B. TASKS PERFORMED**

To complete the work in this area, NorthStar performed the following tasks:

1. Reviewed the relevant portions of the IAWC's testimony, exhibits, and supporting documentation from Docket 09-0319 specific to Human Resources and Employee Services. This included the AWWSC Cost Study for IAWC prepared by Deloitte & Touche. Testimony and supporting information was used to develop an understanding of IAWC's justification for obtaining these services from AWWSC, the scope of services provided to IAWC, and the method(s) used to support the costs compared to competitive market providers.
2. Reviewed the Market Cost Comparison of AWWSC Charges prepared by Baryenbruch & Company.
3. Determined whether reports and documentation included in the testimony provide reasonable support for the costs charged to IAWC.
4. Determined the cost of HR and payroll services provided by AWWSC for IAWC during 2010. This included charges at the business unit level for direct charges, allocated charges, and overhead costs.

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<sup>15</sup> DR 110 confidential, 257 confidential; IR 45

<sup>16</sup> DR 110 confidential, 257 confidential

<sup>17</sup> DR 257 confidential

5. Reviewed existing policies and procedures for allocating HR and payroll costs.
6. Reviewed documentation for business units charged and allocated to IAWC.
7. Interviewed HR managers and the employee services manager to gain a better understanding of the related business units, activities, and services provided to IAWC.
8. Identified services and evidence of controls over affiliate costs, including the extent to which cost/benefit and competitive analyses were performed by IAWC.
9. Reviewed data responses to identify metrics, deliverables, and service parameters relative to the services or sub-services provided by AWWSC.
10. Requested and reviewed data on volume and level of services provided to obtain estimates of the volume and level of services used by IAWC.
11. Evaluated the activities performed by AWWSC HR and employee services for outsourcing evaluation.
12. Researched industry standards and benchmarks for level of services and cost.
13. Prepared activity/service groupings for the purpose of determining which potential competitive service providers should be contacted.
14. Contacted HR service providers to explore the feasibility of outsourcing all HR-related functions to a single provider.
15. Contacted potential competitive service providers to obtain pricing for the HR and employee services.
16. Based on research, interviews and other data, developed estimates of competitive prices for as many groups of sub-services as possible.
17. Compared the competitive cost of services to the AWWSC costs.
18. Determined the reasonableness of prices and value of the services provided by AWWSC, given the competitive pricing and all externalities and unique factors.
19. Prepared a task report.

## C. RESULTS

1. **AWWSC erroneously charged IAWC \$21,648 for Eastern Division HR costs. When identified during this study, the Company indicated that this was charged in error and would be corrected.**<sup>18</sup>
2. **AWWSC currently outsources a number of HR activities.**
  - Recruiting, outplacement, the employee assistance program, pre-employment screening services, and some payroll-related services are outsourced.
  - AWWSC also contracts professional services as needed, such as those provided by an employment/labor law firm.
  - The 2010 costs for the above activities are \$161,719.
  - In addition, \$1,526,792 was charged to IAWC for outsourced healthcare benefits (multiple vendors) associated with AWWSC employees. These charges follow labor through benefit overheads and are distributed to each business unit in which there are employees receiving benefits. As result, they are not included in the HR budget, except as they relate to HR employees.<sup>19</sup>
3. **Given IAWC's relatively small workforce size, outsourcing all HR-related services to a single provider is not an option.**
  - BNA's 2011 Annual HR Benchmarking Report (2010 data) concluded that seven out of ten organizations outsourced at least one HR function.<sup>20</sup> According to a 2010 Society for Human Resource Management (SHRM) study of companies that use shared HR service centers, 72 percent of these companies used a combination of in-house and outsourced shared services, which is the approach used by AWWSC for its HR-related services.<sup>21</sup>
  - The 2010 SHRM Human Capital Study (2009 data) identified the outsourcing frequency for 144 responding companies having 750 employees or less, as shown in **Exhibit X-4** below.<sup>22</sup>

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<sup>18</sup> DR 289

<sup>19</sup> DR 107, 403

<sup>20</sup> BNA is a wholly-owned subsidiary of Bloomberg L.P., and a leading source of legal, regulatory, and business information

<sup>21</sup> SHRM Poll: Shared Services and Centers of Excellence, May 2010

<sup>22</sup> SHRM Benchmarking Services